

Department of Legislative Services
 Maryland General Assembly
 2015 Session

FISCAL AND POLICY NOTE

Senate Bill 37 (Senator Madaleno)
 Budget and Taxation and Finance

Tobacco Taxes - Healthy Maryland Initiative

This bill increases the tobacco tax rate from \$2.00 to \$3.00 per pack of cigarettes and generally increases the other tobacco products (OTPs) tax rate from 30% to the greater of 76% of the wholesale price or a specified amount. It also increases specified tobacco business-related fees and establishes a permitting and enforcement framework for “direct tobacco shippers” and tobacco “common carriers,” which covers the shipment, sale, and delivery of pipe tobacco and premium cigars. The bill further requires the Governor to include at least \$21 million in annual funding for the Tobacco Use Prevention and Cessation Program beginning in fiscal 2017.

The bill takes effect July 1, 2015.

Fiscal Summary

State Effect: Net general fund revenues increase by \$95.3 million in FY 2016 due to the increase in the cigarette and OTP tax, minus the loss of sales tax revenues, and from fees increased or established under the bill. General fund expenditures increase by \$11.0 million annually beginning in FY 2017, reflecting mandated tobacco cessation program funding. Future year estimates reflect projected tax and fee revenue and mandated general fund expenditures. The Comptroller can implement the bill with existing resources. General fund expenditures for the Judiciary increase by approximately \$30,000 in FY 2016 for programming costs. **This bill establishes a mandated appropriation beginning in FY 2017.**

(\$ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	\$95.3	\$91.0	\$90.6	\$90.3	\$89.9
GF Expenditure	\$0	\$11.0	\$11.0	\$11.0	\$11.0
Net Effect	\$95.3	\$80.0	\$79.6	\$79.3	\$78.9

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local health departments may benefit from additional funding due to the increased funding for the Tobacco Use Prevention and Cessation Program provided for in the bill.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Taxes

The bill increases the tobacco tax rate from \$2.00 to \$3.00 per pack of cigarettes and generally increases the OTP tax rate from 30% to the greater of 76% of the wholesale price or a specified amount. The tax rate on OTP is:

- *Conventional moist snuff smokeless tobacco:* the greater of 76% of the wholesale price or \$3.00 per 1.2 ounce (or less) container (and a proportionate amount of tax for larger containers).
- *Single-dose smokeless tobacco:* the greater of 76% of the wholesale price or \$2.25 per container of 15 or fewer doses (and a proportionate amount of tax for larger containers).
- *Loose smoking tobacco:* the greater of 76% of the wholesale price or \$3.00 per 0.65 ounces.
- *Nonpremium cigars:* 76% of the wholesale price, but not less than 15 cents per cigar (for cigars with a wholesale price of less than \$20).

In addition, the definition of “cigarette” is altered to include cigarette-sized cigars (tobacco that is wrapped in any substance containing tobacco and has a filter) and similar items, which are taxed at the same rate as regular cigarettes under the bill. The OTP tax rate on premium cigars is left unchanged at 15%. The bill also alters the value of the vendor discount available to a licensed cigarette wholesaler from 0.82% of the purchase price to 1.6 cents per tax stamp, and it imposes a one-time floor tax on cigarettes and OTP in fiscal 2016.

Fees

The bill raises a number of tobacco business-related fees paid to either the clerk of the court or the Comptroller. The fee increases are in addition to an initial application fee as specified in current law. The fees payable to the Comptroller are increased:

- for a license to act as a manufacturer, from \$25 to \$250;
- for a license to act as a storage warehouse, from \$25 to \$200;
- for a license to act as an OTP manufacturer, from \$25 to \$250; and
- for a license to act as an OTP storage warehouse, from \$25 to \$250.

In addition, the renewal fee for certain tobacco-related licenses issued by the Comptroller is increased from \$30 to \$200. Specific fee increases payable to the clerk of the court are:

- for a license to act as a retailer, from \$30 to \$250; and
- for a license to act as an OTP retailer or tobacconist, from \$15 to \$200.

Direct Tobacco Shippers and Tobacco Common Carriers

The bill also establishes a permitting and enforcement framework for “direct tobacco shippers” and “tobacco common carriers,” which covers the shipment, sale, and delivery (including home delivery) of pipe tobacco and premium cigars.

A direct tobacco shipper permit issued under the bill authorizes the holder to *sell* and *ship* pipe tobacco and premium cigars through a holder of a tobacco common carrier permit to a consumer in the State by receiving and filling orders that the consumer transmits by electronic or other means. A tobacco common carrier permit issued under the bill authorizes the holder to *transport* pipe tobacco and premium cigars from a direct tobacco shipper to a consumer, subject to specified restrictions. The initial and renewal fee for a direct tobacco shipper permit is \$200. The fee for a tobacco common carrier permit is \$100, and no renewal fee is specified.

To complete delivery of a shipment, a tobacco common carrier must require from a consumer at the address listed on the shipping label: (1) the signature of the consumer or another individual at the address who is at least 18 years old; and (2) the government-issued photographic identification of the individual signing for the delivery. A tobacco common carrier is prohibited from delivering a shipment without a signature and valid identification. An individual who receives a shipment of pipe tobacco or premium cigars under the bill must use the shipment for personal consumption only and is prohibited from reselling the items.

Both direct tobacco shippers and tobacco common carriers must report quarterly to the Comptroller on specified information related to their business operations and retain business records for three years. Direct tobacco shippers must also file a quarterly tax return (as required by regulation) and pay quarterly tobacco taxes as if the sales were made in the State.

A violation of the provisions related to direct tobacco shippers and tobacco common carriers is a misdemeanor and is subject to a maximum penalty of a \$1,000 fine and/or 30 days imprisonment. Each violation is a separate violation. The Comptroller may adopt regulations to implement these provisions.

Mandated Appropriation

The bill requires the Governor to include at least \$21 million in annual funding for the Tobacco Use Prevention and Cessation Program beginning in fiscal 2017.

Current Law: Cigarettes are taxed at a rate of \$2.00 per pack. OTPs are taxed at 30% of the wholesale price for all products, except cigars. The tax rate for cigars that are classified as premium cigars equals 15% of the wholesale price; all other cigars are taxed at 70% of the wholesale price. Cigarette and OTP tax revenues accrue to the general fund. In addition, the State sales tax rate of 6% is imposed on the final retail price of cigarettes and OTPs. Cigarette tax revenues are estimated to total \$357.6 million and OTP tax revenues are estimated to total \$34.0 million in fiscal 2016. Most tobacco-related fees increased by the bill are currently \$25 to \$30 and are paid either to the Comptroller or the local clerk of the court.

Background:

Tobacco Taxes

Chapter 121 of 1999 increased the cigarette tax from 36 cents to 66 cents. In addition, Chapter 121 imposed a 15% tax on the wholesale price of OTPs such as cigars and smokeless tobacco. Chapter 288 of 2002 increased the cigarette tax from 66 cents to \$1.00 per pack. Chapter 6 of the 2007 special session increased the cigarette tax to \$2.00 per pack. In fiscal 2010, of the total amount of OTPs reported sold by wholesalers, 63% was cigars, followed by moist snuff (25%), chewing tobacco (7%), roll-your-own tobacco (4%), and pipe tobacco (1%).

Chapter 2 of the 2012 first special session increased the OTP tax rate from 15% to 30% of the wholesale price for all products except cigars, effective July 1, 2012. The tax rate for cigars that are classified as premium cigars remained at 15% of the wholesale price; all other cigars are taxed at 70% of the wholesale price.

The Tobacco Use Prevention and Cessation Program aims to reduce the use of tobacco products and to reduce the burden of tobacco-related morbidity and mortality in the State. Over the past several years, the State’s fiscal difficulties have prompted reductions to the mandated funding levels for various programs funded by the Cigarette Restitution Fund. The Budget Reconciliation and Financing Act of 2010 (Chapter 484) reduced annual appropriations for tobacco use prevention and cessation activities to \$6 million in each of fiscal 2011 and 2012 and \$10 million annually beginning in fiscal 2013. Prior to these reductions, \$21.0 million was mandated for the activities annually.

Exhibit 1 shows the cigarette and OTP tax rates imposed in Maryland and surrounding states as of January 1, 2015, and the tax rate for moist snuff tobacco in those states that provide for a separate tax.

Exhibit 1
Cigarette, OTP, and Moist Snuff Tobacco Tax Rates in Surrounding States

<u>State</u>	<u>Cigarette Tax Rate</u>	<u>OTP Tax Rate</u>	<u>Moist Snuff Tobacco (per Ounce)</u>
Delaware	\$1.60	15%	\$0.54
District of Columbia	2.50 ¹	70%	0.75
Maryland	2.00	30% ²	
Pennsylvania	1.60	None	
Virginia	0.30 ³	10% ⁴	0.18
West Virginia	0.55	7%	

¹Also imposes an in lieu cigarette sales tax calculated annually and currently equal to \$0.40.

²The tax rate on premium cigars is 15% of the wholesale price and 70% of the wholesale price for all other cigars.

³Counties may impose an additional tax on cigarettes of \$0.02 to \$0.15.

⁴Applied to manufacturing price, chewing tobacco taxed per unit.

Source: Federation of Tax Administrators

Tobacco Use and Health Outcomes

According to the 32nd Surgeon General’s report, *The Health Consequences of Smoking – 50 Years of Progress*, smoking rates among teens and adults are less than half what they were in 1964. However, 42 million American adults and 3 million middle and high school students continue to smoke. Further, even though smokers consume fewer cigarettes than 50 years ago, changes in the design and composition of cigarettes put smokers at a higher

risk of developing lung cancer. The Surgeon General estimates that the economic costs attributable to smoking and exposure to tobacco smoke from both direct medical costs and lost productivity approach \$300 billion annually.

According to the U.S. Centers for Disease Control and Prevention, in Maryland the percentage of individuals 18 or older who smoked cigarettes was 19.1% in 2011. The rate across all states and DC ranged from 11.8% to 29.0%. The percentage of adults who used smokeless tobacco in Maryland was 2.1% during that same time, with a range of 1.4% to 9.8% across all states and DC. Maryland had the eleventh-lowest and eighth-lowest percentages across the states in cigarette and smokeless tobacco use, respectively.

In Maryland, the percentage of youth in grades 9 through 12 who used tobacco in 2011 (cigarettes, smokeless tobacco, and/or cigars) was 17.9%, with a range of 7.8% to 31.9% across 36 states. Maryland was the fourth-lowest percentage across those states.

State Fiscal Effect: The bill increases the cigarette and OTP tax rates, increases certain tobacco business-related fees, establishes two new permit fees, and requires the Governor to include at least \$21.0 million in annual funding for the Tobacco Use Prevention and Cessation Program beginning in fiscal 2017. As a result, general fund revenues increase by \$95.3 million in fiscal 2016, as shown in **Exhibit 2**.

Future year estimates reflect estimated net increases in general fund revenues and an increase of \$11.0 million in general fund expenditures to ensure a total of \$21.0 million in annual tobacco cessation program funding. The Department of Health and Mental Hygiene advises that it would hire five additional employees to conduct additional tobacco cessation initiatives, evaluations, and related expenditures.

The revenue estimates are based on past cigarette tax increases in Maryland and an examination of the additional OTP revenues generated through tax increases in 11 other states in fiscal 2006 through 2010, adjusted for Maryland. Based on these experiences, the estimates assume a significant reduction in the taxable consumption of cigarettes and OTPs following the tax increases.

As a limited number of new permits are anticipated to be issued under the permitting and enforcement framework for direct tobacco shippers and tobacco common carriers, the Comptroller can implement the bill with existing resources. General fund expenditures for the Judiciary increase by approximately \$30,000 in fiscal 2016 for programming costs to update its licensing system.

Exhibit 2
Fiscal Impact of Legislation
Fiscal 2016-2020
(\$ in Millions)

	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>
General Fund Revenues					
Cigarette Tax ¹	\$82.2	\$78.5	\$78.1	\$77.8	\$77.4
OTP Revenues ²	14.2	13.7	13.8	13.8	13.9
Sales Tax	-2.8	-2.8	-2.8	-2.9	-2.9
Fees ³	1.6	1.6	1.6	1.6	1.6
Net General Fund	\$95.3	\$91.0	\$90.6	\$90.3	\$89.9
General Fund Expenditures					
Tobacco Cessation ⁴	\$0	\$11.0	\$11.0	\$11.0	\$11.0
Net Impact	\$95.3	\$80.0	\$79.6	\$79.3	\$78.9

Notes: Numbers may not sum to total due to rounding.

¹Includes impact of one-time floor tax in fiscal 2016 and impact of altering vendor discount.

²Includes impact of one-time floor tax in fiscal 2016.

³Includes impact of increasing existing fees and establishing new fees.

⁴Although the Tobacco Use Prevention and Cessation Program is funded by the Cigarette Restitution Fund, a special fund, nearly the entirety of the fund's revenue is allocated each year to various programs under funding mandates. Therefore, it is assumed that general funds are necessary either to meet the bill's funding mandate or to backfill for funding reallocated from Cigarette Restitution Fund programs.

Small Business Impact: Small businesses that sell cigarettes and OTPs are negatively affected due to the decrease in the sales of these products resulting from the tax increases and from the higher cigarette and OTP retailer fees.

Additional Information

Prior Introductions: Similar legislation has been introduced in the 2011 through 2014 sessions. SB 589 of 2014, SB 700 of 2013, and SB 526 of 2012 each received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. SB 654 of 2011 received an unfavorable report from the Senate Budget and Taxation Committee. Their cross files, HB 443 of 2014, HB 683 of 2013, HB 1153 of 2012, and HB 853 of 2011, each received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 108 (Delegates Luedtke and Frush) – Ways and Means and Economic Matters.

Information Source(s): Comptroller’s Office, Department of Health and Mental Hygiene, Judiciary (Administrative Office of the Courts); Federation of Tax Administrators, U.S. Centers for Disease Control and Prevention, U.S. Department of Health and Human Services, Department of Legislative Services

Fiscal Note History: First Reader - February 2, 2015
md/ljm

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